United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING

75-7503

United States Court of Appeals

FOR THE SECOND CIRCUIT

SUSAN TANNENBAUM,

Plaintiff-Appellant,

—against—

ROBERT G. ZELLER, *et al.*,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF DEFENDANTS-APPELLEES IN SUPPORT OF PETITION FOR REHEARING

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May 17, 1977

United States Court of Appeals

For the Second Circuit

DOCKET NO. 75-7503

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Plaintiff does not dispute in her response to our petition for rehearing that no issue of proxy statement disclosure was alleged in the complaint, specified in the pre-trial order or tried in the District Court.

As we note in our petition, plaintiff's counsel asserted in his opening statement at the trial that

> ". . . The issue here is really a single issue, the failure of the Fund to recapture a portion of the commissions on portfolio transactions, . . ." (App., Tr. 6).

Plaintiff seeks to avoid her counsel's assertion at the trial by arguing that disclosure was "integrally related" to plaintiff's other claims. The relationship is non-existent rather than "integral." The alleged illegality of the directors' decision that recapture was not in the best interests of the Fund poses entirely different questions from whether a possibility of recapture should be disclosed in Fund proxy materials. In any event, it is indisputable that the disclosure issue (no matter whether integrally related to plaintiff's other claims or wholly unrelated) was not properly raised or tried in the District Court.

There is no substance to plaintiff's assurances (p. 6) that because recapture is no longer a viable technique, the panel's decision will have little impact on the mutual fund industry and will not trigger a new wave of mutual fund litigation in the federal courts. Plaintiff apparently reads the panel's decision as specifically limited to non-disclosure of the possibility of recapture during those years in which recapture was possible.

We assure the Court that members of the bar who concern themselves with proxy statement disclosure do not read the opinion so narrowly. Certainly the Investment Company Institute does not consider the panel's opinion to be so inconsequential as plaintiff now argues it to be.

The panel's reasoning and holding was that since conflicts of interest are pervasive in the mutual fund industry, alternatives to important board decisions should be disclosed in Fund proxy statements. Quite obviously, recapture was not *the* most important question ever considered by mutual fund directors. If disclosure of rejected alternatives was required here, there are necessarily many, many other important board decisions which likewise require the disclosure of rejected alternatives.

Plaintiff asserts (p. 6) that

> "Commencing with the *Moses* decision in June 1971, mutual funds *did* begin to disclose in their proxy statements (a) the possibility of recapture and (b) the determination of the fund's board with respect to recapture."

We represent to the Court that plaintiff's assertion is incorrect and we reiterate here the offer of proof we made in our petition for rehearing: During the years 1967 through 1971, most mutual funds rejected recapture as not in their best interests. Almost without exception, no fund which rejected recapture has ever disclosed the reasons for that decision or that recapture was available.

Plaintiff argues that the guidelines published by the Securities and Exchange Commission for prospectus disclosure have no bearing upon the disclosures required in proxy statements. We submit that appraisal of the quality and integrity of Fund management is no less important to a prospective purchaser of Fund shares than it is to an existing shareholder who is asked to vote upon a management contract. In any event, notwithstanding technical or functional differences between prospectuses and proxy statements, the Commission's disclosure guidelines for Fund prospectuses are at least persuasive authority that a fund's failure to pursue recapture is not material to Fund shareholders and is not required to be disclosed in Fund proxy statements.

CONCLUSION

The panel erred in holding that Fund proxy statements for the years 1967 through 1971 were false and misleading for failing to disclose the possibility of recapture which an independent board of directors had properly rejected in the independent exercise of business judgment as not in the best interests of the Fund. The Fund directors having rejected recapture, disclosure of the rejected alternative was not material. Accordingly, the petition for rehearing should be granted and, on rehearing, the judgment of the District Court dismissing the complaint should be affirmed. Alternatively, any question of the adequacy of the Fund's proxy statements should be remanded to the District Court for trial.

Respectfully submitted,

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Defendants-Appellees. :

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STATE OF NEW YORK)
: SS.:
COUNTY OF NEW YORK)

GEORGE A. SCHOLZE, being duly sworn, deposes and says that he is an attorney associated with Sullivan & Cromwell, attorneys for Defendants-Appellees F. Eberstadt & Co., Inc., F. Eberstadt & Co., Managers and Distributors, Inc. and Robert G. Zeller; that on the 17th day of May, 1977 he caused the within Reply Brief to be served upon the following attorneys at the following addresses by having two true copies of the same to each, securely enclosed in a postpaid wrapper to be deposited in the Post Office Box regularly maintained by the United States Government at 48 Wall Street, Borough of Manhattan, City and State of New York, directed to said attorneys at said addresses as follows:

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George A. Scholze

Sworn to before me this
17th day of May, 1977

BRUCE H. ARCH
NOTARY PUBLIC, State of New York
Residing in Queens County
Queens Co. Clk's No. 41-4609678
Certificate Filed in
New York Co. Clk's
Commission Expires March 30, 1979

Bruce H. Arch
Notary Public